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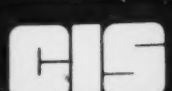

DESCRIPTION OF TAX PROVISIONS OF H.R. 1555 AND S. 750

(TITLE I OF THE TECHNICAL CORRECTIONS ACT OF 1991)

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the tax provisions of H.R. 1555 and S. 750 (Title I of the Technical Corrections Act of 1991), introduced on March 21, 1991, by Chairman Rostenkowski and Chairman Bentsen, respectively. (H.R. 1555 and S. 750 also contain technical corrections to certain health, social security, and trade provisions, which are not described in this document.)

Part I of the document describes technical corrections to the Revenue Reconciliation Act of 1990 ("1990 Act").[2] Part II describes technical corrections to other recent tax legislation.

The amendments made by Title I of the Technical Corrections Act of 1991 are intended to correct, clarify, or conform various recently enacted tax provisions. Provisions in the bill are generally effective as if included in the original legislation, unless otherwise specified. Provisions in the bill for which no descriptions are provided are clerical in nature.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of Tax Provisions of H.R. 1555 and S. 750 (Title I of the Technical Corrections Act of 1991) (JCX-5-91), March 21, 1991.

[2] Title XI of the Omnibus Budget Reconciliation Act of 1990 (P.L. 101-508). The provisions in Part I relate to the order of the respective subtitles of Title XI of the 1990 Act.

TITLE I. TAX TECHNICAL CORRECTIONS

I. TECHNICAL CORRECTIONS TO THE REVENUE RECONCILIATION ACT OF 1990

A. Individual Income Tax Provisions

1. Minimum tax rate on certain nonresident aliens (sec. 102(a)(2) of the bill, sec. 11102 of the 1990 Act, and sec. 897 of the Code)

Present Law

The Revenue Reconciliation Act of 1990 (the "1990 Act") increased the alternative minimum tax rate on individuals from 21 percent to 24 percent.

Explanation of Provision

The bill conforms the rate of the minimum tax on the U.S. real property gains of nonresident aliens to the 24 percent minimum tax rate enacted in the 1990 Act.

2. Tax rate of personal holding companies (sec. 102(a)(4) of the bill, sec. 11101 of the 1990 Act, and sec. 541 of the Code)

Present Law

A corporation that is treated as a personal holding company is subject, in addition to the regular corporate tax, to a 28-percent tax on its undistributed personal holding company income for the taxable year. The present-law rate of 28 percent was set by the Tax Reform Act of 1986.[1] This rate reflected the maximum rate of tax on individuals in that Act.

The 1990 Act increased the maximum rate of tax on individuals from 28 percent to 31 percent effective for taxable years beginning after December 31, 1990.

Explanation of Provision

The bill provides that the increase in the individual maximum tax rate to 31 percent also applies to the personal holding company tax rate, effective for taxable years beginning after December 31, 1990.

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[1] See P.L. 99-514, sec. 104 (b)(8).

3. Definition of AGI for the earned income credit and the supplemental earned income tax credit for health insurance premiums (sec. 102(a)(5) of the bill, sec. 11111 of the 1990 Act, and sec. 32 of the Code)

Present Law

Under present law, a supplemental earned income tax credit (EITC) is available to certain taxpayers for qualified health insurance expenses. Qualified health insurance expenses for which the credit is available are amounts paid during the taxable year for health insurance coverage that includes one or more qualifying children. These expenses include only those expenses relating to the cost of coverage (i.e., premium cost) paid with after-tax dollars. The maximum credit is $428 in 1991. The credit is phased out as adjusted gross income (AGI) (or earned income, if greater) exceeds $11,250 in 1991. Earned income amounts taken into account in computing the maximum credit and the beginning point of the phase-out range are indexed for inflation.

The calculation of this supplemental child health insurance credit is generally the same as the calculation of the basic EITC. Thus, the same eligibility criteria and income phase-in and phase-out requirements apply. There is no family size adjustment with respect to the health insurance credit.

Present law provides that the amount of expenses taken into account in determining the deduction for health insurance costs of self-employed individuals (sec. 162(l)) is reduced by the amount (if any) of the supplemental child health insurance credit allowable to the taxpayer (sec. 162(l)(3)(B)). This so-called "double-dip" provision creates a calculation problem because the amount of the EITC, the supplemental young child credit, and the child health insurance credit cannot be determined until AGI is determined; however, AGI is determined with reference to the deduction for health insurance costs of self-employed individuals. Thus, the operation of the double-dip provision creates a circularity that increases the complexity of the child health credit.

Explanation of Provision

Under the bill, for purposes of the EITC, the supplemental young child credit, and the supplemental child health insurance credit, AGI is calculated assuming that the taxpayer is entitled to the full deduction for health insurance costs under section 162(l). Then, after the maximum child health credit is determined, the double-dip rule (sec. 162(l)(3)(B)) operates as it does under present law.

B. Excise Tax Provisions

1. Application of the 2.5-cents-per-gallon tax on fuel used in rail transportation to States and local governments (sec. 102(b)(3) of the bill, sec. 11211(b)(4) of the 1990 Act, and sec. 4093 of the Code)

Present Law

The 1990 Act increased the highway and motorboat fuels taxes by 5 cents per gallon, effective on December 1, 1990. The 1990 Act continued the exemption from these taxes for fuels used by States and local governments.

The 1990 Act also imposed a 2.5-cents-per-gallon tax on fuel used in rail transportation, also effective on December 1, 1990. Because of a drafting error in the 1990 Act, the 2.5-cents-per-gallon tax on fuel used in rail transportation incorrectly applies to States and local governments.

Explanation of Provision

The bill clarifies that the 2.5-cents-per-gallon tax on fuel used in rail transportation will not apply to such uses by States and local governments.

2. Deposit of certain aviation tax revenues in Airport and Airway Trust Fund (sec. 102(b)(5) of the bill, sec. 11213 of the 1990 Act, and sec. 9502(e)(1) of the Code)

Present Law

The 1990 Act increased the aviation excise tax rates (except for the international air departure tax rate) by 25 percent, and extended those taxes for five years, effective December 1, 1990, through December 31, 1995. From December 1, 1990 through 1992, the statement of managers on the 1990 Act indicated that the revenues attributable to the increased portion of the aviation taxes were to be retained in the General Fund; these revenues will be deposited in the Airport and Airway Trust Fund for 1993 through 1995. The statute as enacted in the 1990 Act omitted this agreement with respect to the taxes other than those imposed on aviation fuels (i.e., the revenues attributable to the increase in the air passenger ticket tax and the air cargo tax).

Explanation of Provision

The bill clarifies that revenues from all aviation excise taxes attributable to the increased rates imposed by the 1990 Act on taxable events during periods before January 1, 1993, will be retained in the General Fund. The amendment does not affect revenues attributable to the tax rates

imposed before enactment of the 1990 Act and extended by that Act.

C. Other Revenue-Increase Provisions of the 1990 Act

1. Deposits of Railroad Retirement Tax Act taxes (sec. 102(c)(3) of the bill, sec. 11334 of the 1990 Act, and sec. 6302(g) of the Code)

Present Law

Employers must deposit income taxes withheld from employees' wages and FICA taxes that are equal to or greater than $100,000 by the close of the next banking day. Under the Railroad Retirement Solvency Act of 1983, the deposit rules for withheld income taxes and FICA taxes automatically apply to Railroad Retirement Tax Act taxes (sec. 226 of P.L. 98-76).

Explanation of Provision

The bill conforms the Internal Revenue Code to the Railroad Retirement Solvency Act of 1983 by stating in the Code that these deposit rules for withheld income taxes and FICA taxes apply to Railroad Retirement Tax Act taxes.

2. Treatment of salvage and subrogation of property and casualty insurance companies (sec. 102(c)(4) of the bill and sec. 11305 of the 1990 Act)

Present Law

For taxable years beginning after December 31, 1989, property and casualty insurance companies are required to reduce the deduction allowed for losses incurred (both paid and unpaid) by estimated recoveries of salvage and subrogation attributable to such losses. In the case of any property and casualty insurance company that took into account estimated salvage and subrogation recoverable in determining losses incurred for its last taxable year beginning before January 1, 1990, 87 percent of the discounted amount of the estimated salvage and subrogation recoverable as of the close of the last taxable year beginning before January 1, 1990, is allowed as a deduction ratably over the first 4 taxable years beginning after December 31, 1989. This special deduction was enacted in order to provide such property and casualty insurance companies with substantially the same Federal income tax treatment as that provided to those property and casualty insurance companies that prior to the Revenue Reconciliation Act of 1990 did not take into account estimated salvage and subrogation recoverable in determining losses incurred.

Explanation of Provision

The bill provides that the earnings and profits of any

property and casualty insurance company that took into account estimated salvage and subrogation recoverable in determining losses incurred for its last taxable year beginning before January 1, 1990, is to be determined without regard to the special deduction that is allowed over the first 4 taxable years beginning after December 31, 1989. The special deduction is to be taken into account, however, in determining earnings and profits for purposes of applying sections 56, 902, 952(c)(1) and 960 of the Internal Revenue Code of 1986. This provision is considered necessary in order to provide those property and casualty insurance companies that took into account estimated salvage and subrogation recoverable in determining losses incurred with substantially the same Federal income tax treatment as that provided to those property and casualty insurance companies that prior to the 1990 Act did not take into account estimated salvage and subrogation recoverable in determining losses incurred.

3. Information with respect to certain foreign-owned or foreign corporations: Suspension of the statute of limitations during certain judicial proceedings (sec. 102(c)(5) of the bill, secs. 11314 and 11315 of the 1990 Act, and secs. 6038A and 6038C of the Code)

Present Law

Any domestic corporation that is 25-percent owned by one foreign person is subject to certain information reporting and recordkeeping requirements with respect to transactions carried out directly or indirectly with certain foreign persons treated as related to the domestic corporation ("reportable transactions") (sec. 6038A(a)). In addition, the Code provides procedures whereby an IRS examination request or summons with respect to reportable transactions can be served on foreign related persons through the domestic corporation (sec. 6038A(e)). Similar provisions apply to any foreign corporation engaged in a trade or business within the United States, with respect to information, records, examination requests, and summonses pertaining to the computation of its liability for tax in the United States (sec. 6038C). Certain noncompliance rules may be applied by the Internal Revenue Service in the case of the failure by a domestic corporation to comply with a summons pertaining to a reportable transaction (a "6038A summons") (sec. 6038A(e)), or the failure by a foreign corporation engaged in a U.S. trade or business to comply with a summons issued for purposes of determining the foreign corporation's liability for tax in the United States (a "6038C summons") (sec. 6038C(d)).

Any corporation that is subject to the provisions of section 6038A or 6038C has the right to petition a Federal district court to quash a 6038A or 6038C summons, or to

review a determination by the IRS that the corporation did not substantially comply in a timely manner with the 6038A or 6038C summons (sec. 6038A(e)(4)(A) and (B); sec. 6038C(d)(4)). During the period that either such judicial proceeding is pending (including appeals), and for up to 90 days thereafter, the statute of limitations is suspended with respect to any transaction (or item, in the case of a foreign corporation) to which the summons relates (secs. 6038A(e)(4)(D), 6038C(d)(4)).

The legislative history of the 1989 Act amendments to section 6038A states that the suspension of the statute of limitations applies to "the taxable year(s) at issue."[2] The legislative history of the 1990 Act, which added section 6038C to the Code, uses the same language.[3]

Explanation of Provision

The bill modifies the provisions in sections 6038A and 6038C that suspend the statute of limitations to clarify that the suspension applies to any taxable year the determination of the amount of tax imposed for which is affected by the transaction or item to which the summons relates.

4. Rate of interest for large corporate underpayments (secs. 102(c)(6) and (7) of the bill, sec. 11341 of the 1990 Act, and sec. 6621(c) of the Code)

Present Law

The rate of interest otherwise applicable to underpayments of tax is increased by two percent in the case of large corporate underpayments (generally defined to exceed $100,000), applicable to periods after the 30th day following the earlier of a notice of proposed deficiency, the furnishing of a statutory notice of deficiency, or an assessment notice issued in connection with a nondeficiency procedure.

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[2] H.R. Rep. No. 247, 101st Cong., 1st Sess. 1301 (1989); "Explanation of Provisions Approved by the Committee on October 3, 1989," Senate Finance Committee Print (WMCP: 101-37), 101st Cong., 1st Sess. 118 (October 12, 1989).

[3] "Legislative History of Ways and Means Democratic Alternative," House Ways and Means Committee Print (WCMP: 101-37), 101st Cong., 2nd Sess. 58 (October 15, 1990); Report language submitted by the Senate Finance Committee to the Senate Budget Committee on S. 3299, 136 Cong. Rec. S 15629, S 15700 (1990).

Explanation of Provision

The bill provides that an IRS notice that is later withdrawn because it was issued in error does not trigger the higher rate of interest. The bill also corrects an incorrect reference to "this subtitle".

D. Expiring Tax Provisions

1. Exclusion for employer-provided educational assistance (sec. 102(d)(1) of the bill, sec. 11403 of the 1990 Act, and secs. 127 and 132 of the Code)

Present Law

Employer-provided educational assistance is excludable from gross income if the value of the assistance does not exceed $5,250 and certain other requirements are satisfied (sec. 127). Prior to the 1990 Act, the exclusion did not apply to graduate level courses. The 1990 Act eliminated this restriction. The Omnibus Budget Reconciliation Act of 1989 provided that educational assistance that is not excludable under section 127 due to the dollar limitation on the exclusion and the restriction on graduate level courses is excludable from gross income if and only if it qualifies as a working condition fringe benefit (sec. 132(h)).

Explanation of Provision

The bill amends the fringe benefit rules to reflect the fact that the graduate level course restriction has been repealed.

2. Research credit provision: Effective date for repeal of special proration rule (sec. 102(d)(2) of the bill and sec. 11402 of the 1990 Act)

Present Law

The Omnibus Budget Reconciliation Act of 1989 effectively extended the research credit for nine months by prorating certain qualified research expenses incurred before January 1, 1991. The special rule to prorate qualified research expenses applied in the case of any taxable year which began before October 1, 1990, and ended after September 30, 1990. Under this special proration rule, the amount of qualified research expenses incurred by a taxpayer prior to January 1, 1991, was multiplied by the ratio that the number of days in that taxable year before October 1, 1990, bears to the total number of days in such taxable year before January 1, 1991. The amendments made by the 1989 Act to the research credit (including the new method for calculating a taxpayer's base amount) generally were effective for taxable years beginning after December 31, 1989. However, this effective date did not apply to the special proration rule (which applied to any taxable year which began prior to October 1, 1990--including some years which began before December 31, 1989--if such taxable year ended after September 30, 1990).

Section 11402 of the Omnibus Budget Reconciliation Act

of 1990 extended the research credit through December 31, 1991, and repealed the special proration rule provided for by the 1989 Act. Section 11402 of the 1990 Act was effective for taxable years beginning after December 31, 1989. Thus, in the case of taxable years beginning before December 31, 1989, and ending after September 30, 1990 (e.g., a taxable year of November 1, 1989 through October 31, 1990), the special proration rule provided by the 1989 Act would continue to apply.

Explanation of Provision

The bill repeals for all taxable years ending after December 31, 1989, the special proration rule provided for by the 1989 Act.

E. Energy Tax Provisions: Alternative Minimum Tax Adjustment Based on Energy Preferences (secs. 102(e)(2) and (6) of the bill, sec. 11531(a) of the 1990 Act, and sec. 56(h) of the Code)

Present Law

In computing alternative minimum taxable income (and the adjusted current earnings (ACE) adjustment of the alternative minimum tax), certain adjustments are made to the taxpayer's regular tax treatment for intangible drilling costs (IDCs) and depletion. A special energy deduction is also allowed. The special energy deduction is initially determined by determining the taxpayer's (1) intangible drilling cost preference and (2) the marginal production depletion preference. The intangible drilling cost preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to the adjustments for IDCs. The marginal production depletion preference is the amount by which the taxpayer's alternative minimum taxable income would be reduced if it were computed without regard to depletion adjustments attributable to marginal production. The intangible drilling cost preference is then apportioned between (1) the portion of the preference related to qualified exploratory costs and (2) the remaining portion of the preference. The portion of the preference related to qualified exploratory costs is multiplied by 75 percent and the remaining portion is multiplied by 15 percent. The marginal production depletion preference is multiplied by 50 percent. The three products described above are added together to arrive at the taxpayer's special energy deduction (subject to certain limitations).

The special energy deduction is not allowed to the extent that it exceeds 40 percent of alternative minimum taxable income determined without regard to either this special energy deduction or the alternative tax net operating loss deduction. Any special energy deduction amount limited by the 40-percent threshold may not be carried to another taxable year. In addition, the combination of the special energy deduction, the alternative minimum tax net operating loss and the alternative minimum tax foreign tax credit cannot generally offset, in the aggregate, more than 90 percent of a taxpayer's alternative minimum tax determined without such attributes.

Explanation of Provisions

Interaction of special energy deduction with net operating loss and investment tax credit

The bill clarifies that the amount of alternative tax net operating loss that is utilized in any taxable year is to

be appropriately adjusted to take into account the amount of special energy deduction claimed for that year. This operates to preserve a portion of the alternative tax net operating loss carryover by reducing the amount of net operating loss utilized to the extent of the special energy deduction claimed, which if unused, could not be carried forward.

In addition, the bill contains a similar provision which clarifies that the limitation on the utilization of the investment tax credit for purposes of the alternative minimum tax is to be determined without regard to the special energy deduction.

Interaction of special energy deduction with adjustment based on adjusted current earnings

The bill provides that the ACE adjustment is to be computed without regard to the special energy deduction. Thus, the bill specifies that the ACE adjustment is equal to 75 percent of the excess of a corporation's adjusted current earnings over its alternative minimum taxable income computed without regard to either the ACE adjustment, the alternative tax net operating loss deduction, or the special energy deduction.

F. Estate Freezes (sec. 102(f) of the bill, sec. 11602 of the 1990 Act, and secs. 2701-04 of the Code)

Present Law

Generally

The value of property transferred by gift or includible in the decedent's gross estate is its fair market value. Fair market value is generally the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts (Treas. Reg. sec. 20.2031). Chapter 14 contains rules that supersede the willing buyer, willing seller standard (Code secs. 2701-04).

Preferred interests in corporations and partnerships

Valuation of retained interests

Scope.--Section 2701 provides special rules for valuing certain rights retained in conjunction with the transfer to a family member of an interest in a corporation or partnership. These rules apply to any applicable retained interest held by the transferor or an applicable family member immediately after the transfer of an interest in such entity. An "applicable family member" is, with respect to any transferor, the transferor's spouse, ancestors of the transferor and the spouse, and spouses of such ancestors.

An applicable retained interest is an interest with respect to which there is one of two types of rights ("affected rights"). The first type of affected right is a liquidation, put, call, or conversion right, generally defined as any liquidation, put, call, or conversion right, or similar right, the exercise or nonexercise of which affects the value of the transferred interest. The second type of affected right is a distribution right[4] in an entity in which the transferor and applicable family members hold control immediately before the transfer. In determining control, an individual is treated as holding any interest held by the individual's brothers, sisters and lineal descendents. A distribution right does not include any right with respect to a junior equity interest.

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[4] A distribution right generally is a right to a distribution from a corporation with respect to its stock, or from a partnership with respect to a partner's interest in the partnership.

Valuation.--Section 2701 contains two rules for valuing applicable retained interests. Under the first rule, an affected right other than a right to qualified payments is valued at zero. Under the second rule any retained interest that confers (1) a liquidation, put, call or conversion right and (2) a distribution right that consists of the right to receive a qualified payment is valued on the assumption that each right is exercised in a manner resulting in the lowest value for all such rights (the "lowest value rule"). There is no statutory rule governing the treatment of an applicable retained interest that confers a right to receive a qualified payment, but with respect to which there is no liquidation, put, call or conversion right.

A qualified payment is a dividend payable on a periodic basis and at a fixed rate under cumulative preferred stock (or a comparable payment under a partnership agreement). A transferor or applicable family member may elect not to treat such a dividend (or comparable payment) as a qualified payment. A transferor or applicable family member also may elect to treat any other distribution right as a qualified payment to be paid in the amounts and at the times specified in the election.

Inclusion in transfer tax base.--Failure to make a qualified payment valued under the lowest value rule within four years of its due date generally results in an inclusion in the transfer tax base equal to the difference between the compounded value of the scheduled payments over the compounded value of the payments actually made. The Treasury Department has regulatory authority to make subsequent transfer tax adjustments in the transfer of an applicable retained interest to reflect the increase in a prior taxable gift by reason of section 2701.

Generally, this inclusion occurs if the holder transfers by sale or gift the applicable retained interest during life or at death. In addition, the taxpayer may, by election, treat the payment of the qualified payment as giving rise to an inclusion with respect to prior periods.

The inclusion continues to apply if the applicable retained interest is transferred to an applicable family member. There is no inclusion on a transfer of an applicable retained interest to a spouse for consideration or in a transaction qualifying for the marital deduction but subsequent transfers by the spouse are subject to the inclusion. Other transfers to applicable family members result in an immediate inclusion as well as subjecting the transferee to subsequent inclusions.

Minimum value of residual interest

Section 2701 also establishes a minimum value for a

junior equity interest in a corporation or partnership. For partnerships, a junior equity interest is an interest under which the rights to income and capital are junior to the rights of all other classes of equity interests.

Trusts and term interests in property

The value of a transfer in trust is the value of the entire property less the value of rights in the property retained by the grantor. Section 2702 provides that in determining the extent to which a transfer of an interest in trust to a member of the transferor's family is a gift, the value of an interest retained by the transferor or an applicable family member is zero unless such interest takes certain prescribed forms.

For a transfer with respect to a specified portion of property, section 2702 applies only to such portion. The section does not apply to the extent that the transfer is incomplete.

Options and buy-sell agreements

A restriction upon the sale or transfer of property may reduce its fair market value. Treasury regulations provide that a restriction is to be disregarded unless the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than full and adequate consideration (Treas. Reg. sec. 20.2031-2(h)).

Section 2703 provides that for transfer tax purposes the value of property is determined without regard to any option, agreement or other right to acquire or use the property at less than fair market value or any restriction on the right to sell or use such property. Certain options are excepted from this rule. To fall within the exception, the option, agreement, right or restriction must (1) be a bona fide business arrangement, (2) not be a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth, and (3) have terms comparable to similar arrangements entered into by persons in an arm's length transaction.

Explanation of Provisions

Preferred interests in corporations and partnerships

Valuation

The bill provides that an applicable retained interest conferring a distribution right to qualified payments with respect to which there is no liquidation, put, call, or conversion right is valued without regard to section 2701.

The bill also provides that the retention of such right gives rise to potential inclusion in the transfer tax base. In making these changes, it is understood that Treasury regulations could provide, in appropriate circumstances, that a right to receive amounts on liquidation of the corporation or partnership constitutes a liquidation right within the meaning of section 2701 if the transferor, alone or with others, holds the right to cause liquidation.

The bill modifies the definition of junior equity interest by granting regulatory authority to treat a partnership interest with rights that are junior with respect to either income or capital as a junior equity interest. The bill also modifies the definition of distribution right by replacing the junior equity interest exception with an exception for a right under an interest that is junior to the rights of the transferred interest. As a result, section 2701 does not affect the valuation of a transferred interest that is senior to the retained interest, even if the retained interest is not a junior equity interest.

The bill modifies the rules for electing into or out of qualified payment treatment. A dividend payable on a periodic basis and at a fixed rate under a cumulative preferred stock held by the transferor is treated as a qualified payment unless the transferor elects otherwise. If held by an applicable family member, such stock is not treated as a qualified payment unless the holder so elects.[5] In addition, a transferor or applicable family member holding any other distribution right may treat such right as a qualified payment to be paid in the amounts and at the times specified in the election.

Inclusion in transfer tax base

The bill grants the Treasury Department regulatory authority to make subsequent transfer tax adjustments to reflect the inclusion of unpaid amounts with respect to a qualified payment. This authority, for example, would permit the Treasury Department to eliminate the double taxation that might occur if, with respect to a transfer, both the inclusion and the value of qualified payment arrearages were included in the transfer tax base. It would also permit elimination of the double taxation that might result from a transfer to a spouse, who, under the statute, is both an applicable family member and a member of the transferor's family.

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[5] With respect to gifts made in 1990, the bill provides that this election may be made by the due date (including extensions) of the transferor's 1991 gift tax return.

The bill treats a transfer to a spouse falling under the annual exclusion the same as a transfer qualifying for the marital deduction. Thus, no inclusion would occur upon the transfer of an applicable retained interest to a spouse, but subsequent transfers by the spouse would be subject to inclusion. The bill also clarifies that the inclusion continues to apply if an applicable family member transfers a right to qualified payments to the transferor.

The provision clarifies the consequences of electing to treat a distribution as giving rise to an inclusion. Under the bill, the election gives rise to an inclusion only with respect to the payment for which the election is made. The inclusion with respect to other payments is unaffected.

Trust and term interests in property

The bill conforms section 2702 to existing regulatory terminology by substituting the term "incomplete gift" for "incomplete transfer." In addition, the bill limits the exception for incomplete gifts to instances in which the entire gift is incomplete. The Treasury Department is granted regulatory authority, however, to create additional exceptions not inconsistent with the purposes of the section. This authority, for example, could be used to except a charitable trust that meets the requirements of section 664 and that does not otherwise create an opportunity for transferring property to a family member free of transfer tax.

Options and buy-sell agreements

The bill modifies the exception to the rule disregarding an option for transfer tax valuation. The requirement that the option, agreement, right or restriction not be a device to transfer the property to members of the decedent's family is revised to require that the option not be a device to transfer the property to persons who are natural objects of the bounty of the transferor. This revision conforms section 2703 to the Treasury regulations and recognizes that the section applies with respect to all transfer taxes.

G. Miscellaneous Provisions

1. Conforming amendments to the repeal of the General Utilities doctrine (sec. 102(g)(1) and (2) of the bill, sec. 11702(e)(2) of the 1990 Act, and secs. 897(f) and 1248 of the Code)

Present Law

As a result of changes made by recent tax legislation, gain is generally recognized on the distribution of appreciated property by a corporation to its shareholders. The Technical Corrections subtitle of the 1990 Act and technical correction provisions in prior acts made various conforming amendments arising out of these changes. For example, the 1990 Act made a conforming change to section 355(c) to state the treatment of distributions in section 355 transactions in the affirmative rather than by reference to the provisions of section 311. In addition, the Technical and Miscellaneous Revenue Act of 1988 (the "1988 Act") made a conforming change to section 1248(f) to update the references to the nonrecognition provisions contained in that subsection. One of the changes was to change the reference to "section 311(a)" from "section 311".

Explanation of Provisions

The bill makes three conforming changes to the Code.

First, section 897(f), relating to the basis in a United States real property interest distributed to a foreign person, is repealed as deadwood. The basis of the distributed property is its fair market value in accordance with section 301(d).

Second, section 1248(f) is amended to add a reference to section 355(c)(1), which provides generally for the nonrecognition of gain or loss on the distribution of stock or securities in certain subsidiary corporations. This retains the substance of the law as it existed before the conforming change to section 355(c) made by the 1990 Act.

Third, section 1248 is amended to clarify that, notwithstanding the conforming changes made by the 1988 Act, with respect to any transaction in which a U.S. person is treated as realizing gain from the sale or exchange of stock of a controlled foreign corporation, the U.S. person shall be treated as having sold or exchanged the stock for purposes of applying section 1248. Thus if a U.S. person distributes appreciated stock of a controlled foreign corporation to its shareholders in a transaction in which gain is recognized under section 311(b), section 1248 shall be applied as if the stock had been sold or exchanged at its fair market value.

Under section 1248(a), part or all of the gain may be treated as a dividend. Under the bill, the rule treating the distribution for purposes of section 1248 as a sale or exchange also applies where the U.S. person is deemed to distribute the stock under the provisions of section 1248(i). Under section 1248(i), gain will be recognized only to the extent of the amount treated as a dividend under section 1248.

These amendments are not intended to affect the authority of the Secretary to issues regulations under section 1248(f) providing exceptions to the rule recognizing gain in certain distributions (cf. Notice 87-64, 1987-2 C.B. 375).

2. Prohibited transaction rules (sec. 102(g)(3) of the bill, sec. 11701(m) of the 1990 Act, and sec. 4975 of the Code)

Present Law

The Code and title I of the Employee Retirement Income Security Act of 1974 (ERISA) prohibit certain transactions between an employee benefit plan and certain persons related to such plan. An exemption to the prohibited transaction rules of title I of ERISA is provided in the case of sales of employer securities the plan is required to dispose of under the Pension Protection Act of 1987 (ERISA sec. 408(b)(12)). The 1990 Act amended the Code to provide that certain transactions that are exempt from the prohibited transaction rules of ERISA are automatically exempt from the prohibited transaction rules of the Code. The 1990 Act change was intended to be limited to transactions exempt under section 408(b)(12) of ERISA.

Explanation of Provision

The bill conforms the statutory language to legislative intent by providing that transactions that are exempt from the prohibited transaction rules of ERISA by reason of ERISA section 408(b)(12) are also exempt from the prohibited transaction rules of the Code.

3. Effective date of LIFO adjustment for purposes of computing adjusted current earnings (sec. 102(g)(4) of the bill, sec. 11701 of the 1990 Act, sec. 7611(b) of the 1989 Act, and sec. 56(g) of the Code)

Present Law

For purposes of computing the adjusted current earnings (ACE) component of the corporate alternative minimum tax, taxpayers are required to make the LIFO inventory adjustments provided in section 312(n)(4) of the Code. Section 312(n)(4) generally is applicable for purposes of computing earnings

and profits in taxable years beginning after September 30, 1984. The ACE adjustment generally is applicable to taxable years beginning after December 31, 1989.

Explanation of Provision

The bill clarifies that the LIFO inventory adjustment required for ACE purposes shall be computed by applying the rules of section 312(n)(4) only with respect to taxable years beginning after December 31, 1989. The effective date applicable to the determination of earnings and profits (September 30, 1984) is inapplicable for purposes of the ACE LIFO inventory adjustment. Thus, the ACE LIFO adjustment shall be computed with reference to increases (and decreases, to the extent provided in regulations) in the ACE LIFO reserve in taxable years beginning after December 31, 1989.

4. Low-income housing credit (sec. 102(g)(5) of the bill, sec. 11701(a)(11) of the 1990 Act, and sec. 42 of the Code)

Present Law

The amendments to the low-income housing tax credit contained in the Omnibus Budget Reconciliation Act of 1989 generally were effective for a building placed in service after December 31, 1989, to the extent the building was financed by tax-exempt bonds ("a bond-financed building"). This rule applied regardless of when the bonds were issued.

A technical correction enacted in the Omnibus Budget Reconciliation Act of 1990 limited this effective date to buildings financed with bonds issued after December 31, 1989. Thus, the technical correction applied pre-1989 Act law to a bond-financed building placed in service after December 31, 1989, if the bonds were issued before January 1, 1990.

Explanation of Provision

The bill repeals the 1990 technical correction. The bill provides, however, that pre-1989 Act law will apply to a bond-financed building if the owner of the building establishes to the satisfaction of the Secretary of the Treasury reasonable reliance upon the 1990 technical correction.

H. Expired or Obsolete Provisions ("Deadwood Provisions") (sec. 102(h) of the bill and secs. 11801-11816 of the 1990 Act)

Present Law

The 1990 Act repealed and amended numerous sections of the Code by deleting obsolete provisions ("deadwood"). These amendments were not intended to make substantive changes to the tax law.

Explanation of Provisions

The bill makes several amendments to restore the substance of prior law which was inadvertently changed by the deadwood provisions of the 1990 Act. These amendments include (1) a provision restoring the prior-law depreciation treatment of certain energy property (sec. 168(e)(3)(B)(vi)); (2) a provision restoring the prior-law definition of property eligible for expensing (sec. 179(d)); (3) a provision restoring the prior-law rule providing that if any member of an affiliated group of corporations elects the credit under section 901 for foreign taxes paid or accrued, then all members of the group paying or accruing such taxes must elect the credit in order for any dividend paid by a member of the group to qualify for the 100-percent dividends received deduction (sec. 243(b)); and (4) the provisions relating to the collection of State individual income taxes (secs. 6361-6365).

The bill also makes several nonsubstantive clerical amendments to conform the Code to the amendments made by the deadwood provisions. None of these amendments is intended to change the substance of pre-1990 law.

II. OTHER TAX TECHNICAL CORRECTIONS

A. Hedge Bonds (sec. 103(b) of the bill, sec. 11701 of the 1990 Act, and sec. 149(g) of the Code)

Present Law

The 1989 Act provided generally that interest on hedge bonds is not tax-exempt unless prescribed minimum percentages of the proceeds are reasonably expected to be spent at set intervals during the five-year period after issuance of the bonds (sec. 149(g)). A hedge bond is defined generally as a bond (1) at least 85 percent of the proceeds of which are not reasonably expected to be spent within three years following issuance and (2) more than 50 percent of the proceeds of which are invested at substantially guaranteed yields for four years or more.

This restriction does not apply to hedge bonds, however, if at least 95 percent of the proceeds are invested in other tax-exempt bonds (not subject to the alternative minimum tax). The 95-percent investment requirement is not violated if investment earnings exceeding five percent of the proceeds are temporarily invested for up to 30 days pending reinvestment in taxable (including alternative minimum taxable) investments.

Explanation of Provision

The bill clarifies that the 30-day exception for temporary investments of investment earnings applies to amounts (i.e., principal and earnings thereon) temporarily invested during the 30-day period immediately preceding redemption of the bonds as well as such periods preceding reinvestment of the proceeds.

B. Withholding on Distributions from U.S. Real Property Holding Companies (sec. 103(c) of the bill, sec. 129 of the Deficit Reduction Act of 1984, and sec. 1445 of the Code)

Present Law

Under the Foreign Investment in Real Property Tax Act of 1980 (FIRPTA), a foreign investor that disposes of a U.S. real property interest generally is required to pay tax on any gain on the disposition. For this purpose a U.S. real property interest generally includes stock in a domestic corporation that is a U.S. real property holding corporation ("USRPHC"), or was a USRPHC at any time during the previous five years.

A sale or exchange of stock in a USRPHC is an example of a disposition of a U.S. real property interest. In addition, provisions of subchapter C of the Code treat amounts received in certain corporate distributions as amounts received in sales or exchanges, giving rise to tax liability under the FIRPTA rules when a foreign person receives such a distribution from a present or former USRPHC. Thus, amounts received by a foreign shareholder in a USRPHC in a distribution in complete liquidation of the USRPHC are treated as in full payment in exchange for the USRPHC stock, and are therefore subject to tax under FIRPTA (sec. 331; Treas. Reg. sec. 1.897-5T(a)(2)(iii)). Similarly, amounts received by a foreign shareholder in a USRPHC upon redemption of the USRPHC stock are treated as a distribution in part or full payment in exchange for the stock, and are therefore subject to tax under FIRPTA (sec. 302(a); Treas. Reg. sec. 1.897-5T(a)(2)(ii)). Third, amounts received by a foreign shareholder in a USRPHC, in a section 301 distribution from the USRPHC that exceeds the available earnings and profits of the USRPHC, are treated as gain from the sale or exchange of the shareholder's USRPHC stock to the extent that they exceed the shareholder's adjusted basis in the stock; such amounts are therefore also subject to tax under FIRPTA (sec. 301(c)(3); Treas. Reg. sec. 1.897-5T(a)(2)(i)).

FIRPTA withholding

The Tax Reform Act of 1984 established a withholding system to enforce the FIRPTA tax. Unless an exception applies, a transferee of a U.S. real property interest from a foreign person generally is required to withhold the lesser of ten percent of the amount realized (purchase price), or the maximum tax liability on disposition (as determined by the IRS) (sec. 1445).

Although the FIRPTA withholding requirement by its terms generally applies to all dispositions of U.S. real property

interests, and subchapter C treats amounts received in certain distributions as amounts received in sales or exchanges, the FIRPTA withholding provisions also provide express rules for withholding on certain distributions treated as sales or exchanges. Generally, distributions in a transaction to which section 302 (redemptions) or part II of subchapter C (liquidations) applies are subject to 10 percent withholding.[6] Although a section 301 distribution in excess of earnings and profits is also treated as a disposition for purposes of computing the FIRPTA liability of a foreign recipient of the distribution, there is no corresponding withholding provision expressly addressed to the payor of such a distribution.

Explanation of Provision

The bill clarifies that FIRPTA withholding requirements apply to any section 301 distribution to a foreign person by a domestic corporation that is or was a USRPHC, which distribution is not made out of the corporation's earnings and profits and is therefore treated as an amount received in a sale or exchange of a U.S. real property interest. (The bill does not alter the withholding treatment of section 301 distributions by such a corporation that are out of earnings and profits.) Under the bill, the FIRPTA withholding requirements that apply to a section 301 distribution not out of earnings and profits are similar to the requirements applicable to redemption or liquidation distributions to a foreign person by such a corporation. The provision is effective for distributions made after the date of enactment of the bill. No inference is intended as to the FIRPTA withholding requirements applicable to such a distribution under present law.

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[6] Under other rules, dividend distributions (i.e., distributions to which sec. 301(c)(1) applies) to foreign persons by U.S. corporations, including USRPHCs, are subject to 30-percent withholding under the Code. Under treaties, the withholding on a dividend may be reduced to as little as 5 or 15 percent.

C. Treatment of Credits Attributable to Working Interests in Oil and Gas Properties (sec. 103(d) of the bill, sec. 501 of the Tax Reform Act of 1986, and sec. 469 of the Code)

Present Law

Under present law, a working interest in an oil and gas property which does not limit the liability of the taxpayer is not a "passive activity" for purposes of the passive loss rules (sec. 469). However, if any loss from an activity is treated as not being a passive loss by reason of being from a working interest, any net income from the activity in subsequent years is not treated as income from a passive activity, notwithstanding that the activity may otherwise have become passive with respect to the taxpayer.

Explanation of Provision

The bill provides that any credit attributable to a working interest in an oil and gas property, in a taxable year in which the activity is no longer treated as not being a passive activity, will not be treated as attributable to a passive activity to the extent of any tax allocable to the net income from the activity for the taxable year. Any credits from the activity in excess of this amount of tax will continue to be treated as arising from a passive activity and will be treated under the rules generally applicable to the passive activity credit. The provision will apply to taxable years beginning after December 31, 1986.

D. Exclusion From Income For Combat Zone Compensation (sec. 103(e)(4) of the bill and sec. 112 of the Code)

Present Law

The Code provides that gross income does not include compensation received by a taxpayer for active service in the Armed Forces of the United States for any month during any part of which the taxpayer served in a combat zone (or was hospitalized as a result of such service) (limited to $500 per month for officers). The heading refers to "combat pay," although that term is no longer used to refer to special pay provisions for members of the Armed Forces, nor is the exclusion limited to those special pay provisions (hazardous duty pay (37 U.S.C. sec. 301) and hostile fire or imminent danger pay (37 U.S.C. sec. 310)).

Explanation of Provision

The bill modifies the heading of Code section 112 to refer to "combat zone compensation" instead of "combat pay". The bill also makes conforming changes to cross-references elsewhere in the Code.